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China's economy has, over the last three decades, staged the strongest growth over any given period in history, as the country moved away from a purely state-owned, centrally-planned economic system to one where foreign capital and private enterprises are allowed.

Coupled with its immense domestic market and a hunger to catch up and over-take, "China", to international investors, is a byword for tremendous business opportunities. Yet, the word also carries notions of challenges for investors, as they attempt to capture this growth.

From the perspective of Professor TJ Wong from the City University of Hong Kong (CUHK), the root of these challenges can be traced to one word: transparency. Wong, who is also the Dean of CUHK's Faculty of Business Administration as well as the Director of the Center for institutions and Governance at CUHK, was speaking at Singapore Management University recently, as part of the Ho Bee Professorship in Chinese Economy and Business lecture series. (http://www.smu.edu.sg/ho_bee_cebl/speaker.asp)

Opaque transparency

For international investors, the biggest challenge to business in China is the lack of transparency. And according to Wong, this boils down to the country's corporate governance framework.

Corporate governance, by his definition, is "the mechanism of pushing firms to operate efficiently and create value", designed "to prevent potential exploitation of outside investors, particularly shareholders, by corporate insiders, such as the management".

The guiding principles behind corporate governance: firms should not just keep the profits for themselves; they should share them with their investors. The other way to look at it is that the interests of all stakeholders have to be aligned. But beyond these basic principles, specific standards and regulations will vary across countries, industries, or even size of the companies.

Wong likens corporate governance to buying and wearing shoes: there is no "one-size-fits-all" model. However, corporate governance practices are shaped by several basic layers. First, country institutions – that includes the legal system and the government. Second, markets – the dynamics of how labour, products, managers, and financial capital work together. Third, firms – how companies are organised, their ownership and management structures. Last but not least, governance structures and accounting.

Owners and managers

A major issue faced by international investors and businesses operating in China is the lack of a clear separation between ownership and the company's management.

"In a company, there should be two bodies: the board and the professional managers," said Wong. The picture is made more complicated by government presence in large state-owned enterprises or SOEs – legacies of the country's command economic system. While there is a growing number of privately-owned, non-government companies, SOEs still hold a significant presence in China's economy, especially in vital infrastructure-related and finance industries.

"The key to solving the problem is to allocate different rights to different bodies," said Wong. The owner or shareholder should hold rights – to control firms, to share profits, and to sell the first two rights. But because the shareholder has little know how when it comes to controlling the firm, he or she will assign control rights to the board of directors and managers. All in all, there should be a clear distinction between the rights of the board as well as management.

In China's context, ownership of listed SOEs often remains under the state. Chairpersons, board of directors, CEOs and general managers are also likely to be party members and government officials. This leads to suggestions that their responsibilities extend beyond profit-making as they also have social objectives to fulfil.

Interestingly, many of the CEOs become provincial vice-governors after a 3-5 year run at these listed companies, said Wong. This suggests a lack of separation in the decision rights allocation, as managers become owners. And they all come from the same group – the government.

Government-led relationship-based system

The US relies on a structure of laws, regulation and open competition to ensure that companies fall in line. Companies in China, on the other hand, operate within a government-led, relationship-based structure.

"I'm not trying to say that there is any one system that dominates all. These mechanisms exist for a reason," said Wong. For China, a relationship-based system fosters trust, long-term vision, higher efficiency, and the formation of strategic alliances. However, Chinese firms, especially SOEs, are facing challenges on the global stage – they know they will need to play by international rules if they are to increase their trade and connectivity with the rest of the world, and so, they adapt international practices, including accounting standards.

Governance and accounting indicators in China do not necessarily show the whole picture, according to Wong. For example, research has shown that China's information processes are poor, especially when it comes to releasing bad news to investors. Also, while rigorous accounting rules might be prescribed, the actual implementation might not be as tight – and the external auditors hired to sign off the books indicate as much. "As they are state-owned firms, they do not need to signal that they are good. When they issue shares, the government will support them. They get a lot of support from the government because the market is controlled by the government," he noted.

As such, when evaluating a Chinese company, investors should not just look at the governance and accounting indicators. Rather, they should also assess the firm's ownership type, corporate structure and equally important, the political environment in which it operates.

No fixed fix

Wong pointed out that there is no fixed solution for the myriad of issues, to which, Yong Kwek Ping, CEO of private equity firm Inventis Investment Holdings added: nor is there a quick fix.

"This can't be fixed in 3-5 years but we should continue to fight corruption and fix the accounting principles. China needs to link to international society's and market's way of investing. Do it the Western way… or make their system understandable to the West," said Yong, who also suggested that firms could install a suite of good accounting software and incorporate a framework of checks and balances.

Just regulations alone, however, will be insufficient, said John R.V. Palmer, a former deputy managing director of the Monetary Authority of Singapore, the de-facto central bank and regulator of the financial industry; currently a principal consultant at Regulatory Professionals. "Regulations can bring forward guidelines but it does not tell how the owner should behave. Regulators can do a lot but they still cannot solve the problems by themselves," he said.

Just implementing Western rules and standards will not improve corporate governance and accounting quality in China, Wong concurred. "Standards alone do not help. There needs to be more disclosure on key government variables and related party transactions. They are more important than accounting." Other important changes include building the right market infrastructure and systems for companies to operate, as well as levelling the playing field between government-owned and privately-owned firms.

With intra-Asian commerce becoming increasingly intertwined, Wong believes that Hong Kong and Singapore – the region's two financial centres with practices aligned with international norms – can play their part in helping China improve its corporate transparency and professionalism of government-controlled firms.

Singapore, for example, can provide a bonding effect of cross-listing, and give implicit indications that certain firms are up to mark. While there is no quick fix and no fixed solution, Wong is quite certain that Singapore and Hong Kong can move the Asian giant towards greater corporate governance and transparency.

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